

Grandfathered Plans: Cents Or Non-Cents?

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Health Care Reform subjects most employer-sponsored health care plans to many new requirements, which are explained in detail in the other articles in this newsletter. A category of plans – grandfathered plans – are exempt from nine of the requirements.

What is a Grandfathered Plan?

A grandfathered plan is group or individual health coverage in which an individual was enrolled on March 23, 2010, the date the legislation was enacted.

How Long Can It Remain Grandfathered?

A grandfathered plan can remain exempt indefinitely. Collectively bargained plans are exempt from all requirements of the health care legislation until the last of the collective bargaining agreements that incorporate the plan expire. At that point, if the plan has retained its grandfathered status, it can then claim continuing grandfathered status.

The legislation does not define what specifically triggers loss of grandfathered status. Instead, it grants broad authority to the Department of Health and Human Services (HHS) to draft regulations. The legislation does permit three plan modifications that will not cancel grandfathered status: re-enrollment of formerly covered individuals or families, new enrollment of individuals or families and the addition of dependents of already enrolled individuals.

Minor Exemptions

Most of the exemptions are of relatively minor economic and practical significance. They are:

- Postponing until 2014 the requirement to cover adult children eligible for other employer health coverage through age 26
- Covering immunizations and preventive care without cost sharing
- Subjecting disputed claims to external claims procedures
- Providing emergency services without: pre-authorization, differential costs for in-network versus out-of-network services, and requiring the treating physician be a participating provider

- Allowing covered individuals to designate primary care providers, including pediatricians and obstetricians or gynecologists
- Reporting health care quality and wellness initiatives to HHS beginning in 2012
- Incorporating cost-sharing limits on out-of-pocket and deductible expenses, beginning in 2014, and
- Covering routine costs of patients who are part of clinical trials, beginning in 2014

The Major Exemption

The final exemption appears to be the most significant in terms of the cost and design of employer health care plans. It exempts grandfathered plans from the nondiscrimination requirements of Internal Revenue Code Section 105(h) which otherwise take effect on September 23, 2010.

Before the legislation, Code Section 105(h) applied only to self-insured plans and prohibited discrimination in eligibility or benefits that favored "highly compensated individuals." Highly compensated individuals are defined as the five highest paid officers, 10% or greater shareholders, and the highest paid 25% of employees.

Section 105(h) says a plan does not discriminate if it covers one of these three groups:

- 70% or more of all entitled employees
- 80% or more of eligible employees, when at least 70 percent of employees were entitled to enroll, or
- A nondiscriminatory classification of employees

In determining eligibility, the plan may exclude employees with fewer than three years of service, employees under the age of 25, part-time and seasonal employees and employees in a bargaining unit who were excluded through good-faith bargaining.

Discrimination in benefits occurs when an employer provides benefits to the highly compensated but not to all other covered individuals. The penalty for violating this requirement is a tax on the highly compensated individual for the discriminatory benefits.

After September 23, newly adopted insured plans and plans that lose their grandfathered status must immediately comply with the nondiscrimination requirements. Unlike self-insured plans, the penalty for violating the nondiscrimination requirements is not taxation of the affected highly compensated individuals. Instead, a tax will be imposed annually on the sponsor of the plan. The penalty is equal to

\$100 per day for each highly compensated individual to whom the failure relates, capped at \$500,000 or 10% of the employer's annual health expenses for the previous year, whichever is lesser.

Analysis

Insured health plans that may have a problem meeting the Section 105(h) requirements are:

- Plans providing enhanced benefits to select groups of key or highly-paid employees or retirees or to groups of such employees who benefit from severance and early-retirement window packages
- Plans with shorter eligibility requirements for salaried vs. hourly or overtime exempt vs. non-exempt individuals, or for classes of employees identified for purposes of recruiting or retention, and
- Plans with different levels of benefits depending on geographic locations, industry or position to reflect competitive market conditions

If an employer wishes to retain these or other insured plan structures that do not fit within Section 105(h), it must preserve its grandfathered status. At present, we do not know what modifications to a grandfathered plan or group of plans will cause a loss of grandfathered status. The House of Representatives bill, which was rejected, caused a loss of grandfathered status upon a change in "any" term of the plan.

Unfortunately, that leaves much room for HHS to broadly define changes that could cause a loss of grandfathered status. A review of other legislation reasonably supports a conclusion that HHS will do so in order to limit the scope and duration of grandfathered plans. This view is supported by government officials who say grandfathered status is not intended to be indefinite, despite the absence of time limit in the legislation.

Those opinions, coupled with the relatively small penalty of \$2,000 per employee per year for employers that do not provide qualifying health plan coverage, may make employer plans extinct and replace them with a system of health insurance provided through each of the 50-state exchanges or the default plans common to each of the exchanges.

Cents or non-cents? Ultimately, employers will decide.

We Can Help

We are dedicated to serving our clients by understanding and carefully monitoring the legislation, regulatory developments and the marketplace of responses to these provisions. We are committed to assisting our clients in assessing alternatives and designing and implementing cost effective and practical

strategies to comply with the legislation, including decisions to retain, modify or surrender grandfathered plan status.